No. 93-448

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1993

ABRAMSON ENTERPRISES, INC.,

Petitioner,

vs.

ANTHONY P. OLIVE, Director,
Virgin Islands Bureau of Internal Revenue,

Respondent.

consolidated in the District Court of the Virgin Islands, Division of St. Croix with:

ABRAMSON ENTERPRISES, INC.,

Petitioner,

vs.

EDWARD E. THOMAS, Director,
VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

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QUESTIONS PRESENTED FOR REVIEW

1. Did the Third Circuit Court of Appeals fail to consider the impact of later legislation on the same subject matter, the Tax Reform Act of 1986, and of the taxing schemes of various States in its determination that the Surtax imposed by the Virgin Islands Legislature was a federal tax and not deductible under Internal Revenue Code § 164?

2. Did the Third Circuit Court of Appeals substitute its own judgment for that of Congress in interpreting the construction of 48 U.S.C. § 1397, as it relates to Section 164 of the Internal Revenue Code, and judicially legislate a result not intended by Congress by determining that Congress intended that the Virgin Islands receive the full economic impact of the maximum Surtax rate?

3. Did the Third Circuit Court of Appeals fail to consider all of the wording of the Naval Service Appropriation Act of 1922 in its construction of a portion of that statute?

LIST OF PARTIES

The parties to the proceedings below were the Petitioner-Appellee, Abramson Enterprises, Inc., a Virgin Islands corporation, and Anthony P. Olive, Director, Virgin Islands Bureau of Internal Revenue, Respondent-Appellant, consolidated in the District Court of the Virgin Islands, Division of St. Croix with Edward E. Thomas, Director, Virgin Islands Bureau of Internal Revenue, Respondent-Appellant.

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OPINIONS BELOW

The decision of the United States District Court of the Virgin Islands, Division of St. Croix, rendered on March 23, 1992 by the Honorable Edward N. Cahn, J., which entered judgment for Petitioner, has not been reported. The Order of the District Court is reproduced in the Appendix (App. 2). An Order was entered on March 24, 1992 by the District Court amending its Order of March 23, 1992. The amended Order of the District Court is reproduced in the Appendix (App. 4). Respondent subsequently filed a Motion for Reconsideration, which was denied by the District Court by Order dated June 8, 1992 (App. 5).

The Opinion of the Court of Appeals for the Third Circuit, No. 92-7381, reversing the District Court, has not been reported. The Opinion of the Third Circuit Court of Appeals is reproduced in the Appendix (App. 1). Petitioner's Petition for Rehearing and Suggestion of Rehearing En Banc, filed June 11, 1993, was denied by the Third Circuit Court of Appeals on June 22, 1993 (App. 6).

STATEMENT OF JURISDICTION

The Petitioner brought the lawsuits in the District Court of the Virgin Islands under Section 22 of the Virgin Islands Revised Organic Act of 1954, 48 U.S.C. § 1612(a). On March 23, 1992, the District Court found in favor of Petitioner. On Respondent's timely appeal, the Third Circuit Court of Appeals, having jurisdiction under 28 U.S.C. § 1291, heard oral arguments and rendered an Opinion

dated May 28, 1993, reversing the Judgment of the District Court and remanding the case with direction to enter judgment in favor of the Respondent. Petitioner's Petition for Rehearing and Suggestion of Rehearing En Banc filed June 11, 1993 was denied on June 22, 1993.

The jurisdiction of this Court to review the Judgment of the Third Circuit Court of Appeals is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves the Naval Service Appropriation Act of 1922, as codified and amended (48 U.S.C. § 1397) (reproduced at App. 7), Internal Revenue Code § 164 (reproduced at App. 8), Tax Reform Act of 1986 § 1274(b) (reproduced at App. 9) and 33 V.I. Code § 581 (reproduced at App. 10).

STATEMENT OF THE CASE

Under 48 U.S.C. § 1397 and 48 U.S.C. § 1642, as enacted by the Naval Service Appropriation Act of 1922, and subsequent amendments, the Virgin Islands has an income tax system which "mirrors" the United States income tax. 48 U.S.C. § 1397 (hereinafter referred to as the "Naval Appropriation Act § 1397") provides:

> "The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be

paid into the treasuries of said islands; **Provided further, that notwithstanding any other provision of law, the Legislature of the Virgin Islands is authorized to levy a Surtax on all taxpayers in an amount not to exceed 10 per centum of their annual income tax obligation to the government of the Virgin Islands**". (Emphasis added).

Title 48 U.S.C. § 1642 provides, in part:

" . . . Provided, That the term 'inhabitants of the Virgin Islands' as used in this Section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States . . . "

The effect of the "mirror tax system" is that the income laws applicable to the citizens of the Virgin Islands are those tax laws legislated by Congress as provided in the Internal Revenue Code. In 1976, Congress amended Naval Appropriation Act § 1397 to add the language, emphasized above, which gave the Virgin Island's Legislature the authority to impose a tax not to exceed ten percent on the tax computed under the mirror system. P.L. 94-392, § 5, 90 Stat. 1195 (sometimes hereinafter referred to as the "1976 Amendment to the Naval Appropriation Act"). The authority granted by the Congress was not exercised by the Virgin Island's Legislature until 1985 when a ten percent Surtax was imposed by the Virgin Islands Legislature pursuant to 33 V.I. Code § 581. Act No. 5060, V.I. Sess. Laws (1985) (reproduced at App. 10). All revenue collected is paid into the Treasury of the Virgin Islands. 48 U.S.C. § 1397.

One of the income-tax laws " . . . in force in the United States of America . . . ", as set forth in Naval Appropriation Act § 1397, and therefore incorporated by reference into that statute is Internal Revenue Code § 164(a), which provides that:

> "State and local, and foreign, income, war profits, and excess profits taxes are allowed . . . as a deduction for the taxable year within which paid or accrued . . . "

Internal Revenue Code § 164(b)(2) defines "State and local taxes" to include:

> " . . . only a tax imposed by a State, a possession of the United States, or a political subdivision of the foregoing, or by the District of Columbia."

The term "possession" as used in Internal Revenue Code § 164 includes the United States Virgin Islands.

The Petitioner is a corporation organized under the laws of the United States Virgin Islands. The Petitioner paid the 10% corporate Surtax on income imposed by the Virgin Islands Legislature pursuant to 33 V.I. Code § 581 in 1986, 1987 and 1988 and then deducted the Surtax paid from its taxable income pursuant to Internal Revenue Code § 164 in those years. The Respondents denied the deductions by the Petitioner of the Surtax and assessed tax deficiencies against the Petitioner for the taxable years 1986, 1987 and 1988.

The two cases before the Court were commenced with the filing by the Petitioner of a Petition for redetermination of its 1986 tax liability with the District Court of the Virgin Islands and then a subsequent filing by the Petitioner of a Petition for redetermination of its 1987 and

1988 tax liability. These cases were consolidated by Order of the District Court.

Trial on the issues was heard by the District Court for the Virgin Islands on March 17, 1992. The parties agreed by joint written stipulation that all issues before the District Court in both cases, except for the issue relating to the deductibility of the Surtax for the tax years in question, had been resolved. The Court took into evidence by judicial notice the legislative histories f the 1976 amendment to the Naval Appropriation Act, of 33 V.I. Code § 581 and of the Tax Reform Act of 1986 (hereinafter referred to as the "1986 TRA").

On March 23, 1992, the District Court entered an Order (App. 2) stating, in pertinent part, that " . . . (t)he corporate Surtax paid pursuant to 33 V.I. Code § 581 (1991 supp.) is a deductible local income tax within the meaning of those terms as set out in 26 U.S.C. § 164(b)(2) (1988) . . . " The District Court states in its Memorandum accompanying the Order (App. 3) that " . . . as a fact-finder in this consolidated case, [the Court concludes that] Congress intended the Surtax it permitted the Virgin Islands to impose after 1975 to be considered a local tax, as defined by § 164(b)(2) of the Internal Revenue Code".

Respondents subsequently filed a Motion for Reconsideration, which was denied by the District Court by Order dated June 8, 1992 (App. 5). The appeal to the Third Circuit Court of Appeals by the Respondents was from the March 23, 1992 and June 8, 1992 Orders of the District Court.

The Third Circuit Court of Appeals entered an opinion on May 28, 1993 concluding that the Surtax is non-

deductible under Internal Revenue Code § 164 (App. 1). The Court of Appeals reversed the judgment of the District Court and directed that judgment be entered in favor of the Respondents. Circuit Judge Greenberg entered a dissenting opinion (App. 1 beginning at page App. 15.)

The majority opinion of the Third Circuit Court of Appeals determined that Internal Revenue Code § 164 is inapplicable to the Surtax for two reasons. See pages App. 10 through 13 of the Court's Opinion at App. 1. First, the Surtax is a federal tax and thus not deductible under Internal Revenue Code § 164 because the Surtax " . . . is payable into the very same coffers – those of the Virgin Islands – that receive the income tax payments that [the Petitioner] seeks to diminish through the deductions at issue." (App. 1 at page App. 11.) Second, the Respondents:

> " . . . could never realize the full 10% Surtax allowed by Congress because deductions taken pursuant to § 164 would reduce the effective rate of the Virgin Islands Surtax to a level below 10%. Thus application of § 164 to the instant case would not only defy rationality but would serve to frustrate Congress' stated intention of allowing the Virgin Islands to levy a full 10% Surtax on income." (App. 1 at page App. 12.)

Circuit Judge Greenberg dissented from the majority opinion by finding that the Surtax imposed by the Virgin Islands Legislature is a "local" tax as defined in Internal Revenue Code § 164:

> " . . . I would conclude that the basic 'mirror' tax of 48 U.S.C. § 1397, in place since 1921, is a tax 'federal' in character because it is imposed by

Congress without further action by the Virgin Islands legislature. In contrast, the 10% surtax, added to Section 1397 in 1976, is, like the 'local income tax' of Section 1274(b) of the Tax Reform Act of 1986, authorized by Congress but imposed only by an independent enactment of the territorial legislature. Therefore, I believe that the surtax is as much a 'local' tax as a tax imposed by a state. I would hold that the surtax of 48 U.S.C. § 1397 is a deductible 'local' tax within the meaning of 26 U.S.C. § 164." (App. 1 at pages App. 17-18.)

REASONS FOR GRANTING THE WRIT

THE FAILURE BY THE THIRD CIRCUIT COURT OF APPEALS TO CONSIDER THE IMPACT OF LATER LEGISLATION ON THE SAME SUBJECT MATTER, THE TAX REFORM ACT OF 1986, CONFLICTS WITH THE DECISION OF THIS COURT IN *UNITED STATES V. STEWART* AND THE DECISIONS OF COURTS OF APPEAL OF OTHER JURISDICTIONS.

In support of its first rationale, the majority opinion of the Court of Appeals states that " . . . [a]lthough state and federal taxing schemes are necessarily complex and more than occasionally convoluted, we can think of no circumstances (and the parties could not advise us of one) in which the income tax paid to a discrete taxing authority may be reduced by the same authority." See Opinion at page App. 13 of App. 1. This statement by the Court ignores the 1986 TRA at Section 1274(b), which granted authority to the Virgin Islands Legislature to enact a nondiscriminatory tax not limited to ten percent of the tax computed under the mirror system.

> "(b) *Authority to Impose Nondiscriminatory Local Income Taxes.* Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. **Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954** and shall not be treated as taxes to which section 901 of such Code applies." *Tax Reform Act of 1986* § 1274(b). (Emphasis added). (App. 9.)

Any tax imposed by the Virgin Islands Legislature under the authority granted by 1986 TRA § 1274(b) would have the same impact suggested by the Court of Appeals, that of being reduced by the deduction of the tax imposed, yet such a tax would be deductible under Internal Revenue Code § 164. "The Virgin Islands income tax permitted under the Tax Reform Act is, as the majority notes, decidedly deductible by its very terms under I.R.C. § 164". (Dissenting Opinion, App. 1 at page App. 16.)

The Court also fails to consider that the taxing schemes of several States have, at one time or another, been calculated as a percentage of federal income tax, which is reduced by the amount of the tax paid to the State. One example was the taxing scheme imposed by the State of Nebraska effective in tax years 1967 through 1986. Neb. Rev. Stat. § 77-2715(1) (1986 Reissue) defined the method of State income taxation, in pertinent part, as follows:

> "A tax is hereby imposed for each taxable year on the entire income of every resident individual of this state . . . The tax shall be **a flat percentage of**, for each resident individual, **the**

> **taxpayer's adjusted federal income tax liability** for each taxable year . . . " Neb. Rev. Stat. § 77-2715(1) (1986 Reissue) (emphasis added).

The tax imposed under the Nebraska taxing statute and paid to the Nebraska Department of Revenue was reduced by the deduction under Internal Revenue Code § 164 of the same tax. The State of Nebraska could never have received, or expected to receive, the full flat percentage imposed.

It is clear that mere payment " . . . into the very same coffers – those of the Virgin Islands – that receive the income tax payments . . . " does not render the Surtax a federal tax as concluded by the majority of the Third Circuit Court of Appeals. If that were the case, then any tax imposed under the 1986 TRA would also be a federal tax, a result which was not intended by Congress. *See also* the dissenting opinion filed by Circuit Judge Greenberg at page App. 16 of App. 1, wherein he states:

> "One of the majority's chief reasons for finding the surtax nondeductible is that 'because the corporate surtax is a tax on income authorized by Congress it has a federal quality that other taxes imposed by the Virgin Islands legislature may not share.' [Supra, typescript at 11.] The hesitant 'may not' reveals the crux of my disagreement, because in fact all taxes imposed by the Virgin Islands legislature must be authorized by Congress, and therefore all such taxes do share, necessarily, the 'federal quality' of the surtax. While I would agree that one cannot reverse-engineer the 'local' nature of the surtax from the text or the legislative history of the subsequent Tax Reform Act of 1986, I would point out that Section 1274(b) of the Tax Reform

> Act is identical to 48 U.S.C. § 1397 insofar as each is a Congressional authorization for the Virgin Islands legislature to enact taxes. In neither case does the tax actually arise unless the territorial legislature itself enacts the tax that is only permitted, and not imposed, by the act of Congress. The Virgin Islands income tax permitted under the Tax Reform Act is, as the majority notes, decidedly deductible by its very terms under I.R.C. § 164. Thus, the corporate surtax does not have any 'federal quality' in its structure which the clearly deductible tax of Section 1274(b) does not share." (Dissenting Opinion, App. 1 at page App. 16.)

The Naval Service Appropriation Act, as amended in 1976, and the 1986 TRA dealt with the same issue, that of granting the Virgin Islands Legislature the power to enact an income tax in addition to the tax imposed under the mirror system. There is no reference in Naval Appropriation Act § 1397 to Internal Revenue Code § 164, except that:

> "The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States . . . " Naval Service Appropriation Act § 1397.

There further is no reference in the legislative history of the 1976 amendment to the Naval Appropriation Act to the deductibility of the Surtax imposed under Internal Revenue Code § 164. The discussions in the Committee Reports simply indicate that the Virgin Islands was experiencing a shortfall in its revenue as a result of the Tax Reduction Act of 1975 and desired the ability to raise revenue in addition to that generated by the mirror tax

system to offset the shortfall. *See* the prepared statement of the Honorable Cyril E. King, Governor of the Virgin Islands, *A Bill to Authorize Loan Funds for the Government of the Virgin Islands, and for Other Purposes*: Hearing before the U.S. Senate Comm. on Interior and Insular Affairs, 94th Cong., 2nd Sess. on S. 3357, pages 21-24:

> "The revenue shortfall that has occurred in the U.S. Virgin Islands represents a combination of economic decline worldwide and Federal manipulation of the income tax system, with its resulting impact on government collections due to the special operation of the Internal Revenue laws within the Virgin Islands.
>
> . . .
>
> Unilateral actions on the part of the Federal Government have also complicated our situation. The changes to the income tax rates with its liberalized exemptions, and negative income provision, have further eroded the revenue base of the local government. The provisions of the U.S. law which tie the income tax of the Virgin Islands government to the Internal Revenue Laws of the United States preclude adjusting tax assessments to compensate for reductions in revenue receipts.
>
> . . .
>
> Also requested [in addition to a loan] is approval of a tax surcharge thereby allowing the legislature the flexibility to respond to subsequent changes of the Federal income tax laws".

See also H.R. Comm. Rep. No. 94-1080 on H.R. 13359 and S. Rep. No. 94-1021 on H.R. 13359. There was no discussion regarding why the Surtax method of taxation was

chosen by Congress, other than the suggestion by Governor King, or why the ceiling on the Surtax was set at 10%. *See also* the dissenting opinion filed by Circuit Judge Greenberg at page App. 17 of App. 1, wherein he states:

> "We simply cannot say from the statute or the legislative history, whether Congress wanted the Virgin Islands to accomplish a full 10% revenue enhancement through the surtax, or whether Congress was satisfied to authorize some lesser percentage of revenue enhancement".

This Court has stated on numerous occasions that " . . . where resolution of a question of federal law turns on statute and the intention of Congress, the court must look first at the statutory language and then to legislative history if the statutory language is unclear". *Blum v. Stenson*, 465 U.S. 886, 896 (1984). In this case, the legislative history of the statute offers no guidance as to the intention of Congress.

As noted above, the 1976 amendment to the Naval Appropriation Act and Section 1274(b) of the 1986 TRA dealt with the same issue, that of granting the Virgin Islands Legislature the power to enact an income tax in addition to the tax imposed under the mirror system. Section 1274(b) of the 1986 TRA states that any such tax " . . . shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies." *Tax Reform Act of 1986* § 1274(b). These two statutes are thus "in pari materia", of the same subject matter, and must be construed together and applied harmoniously and consistently. *United States v. Stewart*, 311 U.S. 60, 64 (1940).

It is clear from the legislative history of the 1986 TRA, and from the language of 1986 TRA § 1274(b), that Congress desired to replace the Surtax with authority granted to the Virgin Islands Legislature to enact a non-discriminatory tax not limited to ten percent of the tax computed under the mirror system in order to promote fiscal autonomy of the Virgin Islands. *See Senate Fin. Comm. Rep. on H.R. 3838, General Explanation* (reproduced in pertinent part at App. 11.) It is further clear that Congress intended the taxes imposed in addition to the tax computed under the mirror system to be deductible under Internal Revenue Code § 164. *Id.* Discussing the law in existence prior to the 1986 TRA, the Senate Finance Committee made the following remarks:

> "The Virgin Islands is **authorized to impose** up to a 10-percent Surtax on the mirror system tax. Otherwise, the Virgin Islands does not have the power to impose **local taxes** on income". *Senate Fin. Comm. Rep. on H.R. 3838, General Explanation* (emphasis added). (App. 11.)

These remarks reveal that Congress, in 1986, believed that the Surtax was a "local tax" on income. There is no indication in the legislative history of the 1986 TRA that Congress believed the Surtax adopted by the Virgin Islands Legislature pursuant to the authority granted to it by the 1976 amendment to the Naval Appropriation Act to be nondeductible, nor is there any indication that Congress felt a change was necessary in that regard. There is, on the other hand, every indication that Congress intended to continue the tax consequences of the Surtex imposed by the Virgin Islands Legislature.

The United States Supreme Court stated in *United States v. Stewart*, 311 U.S. at 64-65, involving the interpretation of statutes enacted twelve years apart, that:

> "It is clear that 'all acts in pari materia are to be taken together, as if they are one law.' *United States v. Freeman*, 3 How. 556, 564, 11 L.Ed. 724. That these two acts are in pari materia is plain. Both deal with the same subject matter, viz., the scope of the tax exemption afforded farm loan bonds. The later act can therefore be regarded as a legislative interpretation of the earlier act (*Cope v. Cope*, 137 U.S. 682, 688, 11 S. Ct. 222, 224, 34 L.Ed. 832; Cf. *Stockdale v. Atlantic Insurance Company*, 20 Wall. 323, 331, 332, 22 L.Ed. 348) in the sense that it aids in ascertaining the meaning of the words as used in their contemporary setting. **It is therefore entitled to great weight in resolving any ambiguities and doubts.**" (Emphasis added.)

See also the separate opinion of Justices Brennan, White, Marshall and Blackmun in *Regents of University of California v. Bakke*, 438 U.S. 265, 349-50 (1978):

> "We have previously recognized that subsequent legislation reflecting an interpretation of an earlier Act is entitled to great weight in determining the meaning of an earlier statute".

This Court further stated in *Red Lion Broadcasting v. FCC*, 395 U.S. 367, 380-81 (1969):

> "Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction".

The Tenth Circuit Court of Appeals stated in *James v. Ford Motor Credit Co.*, 638 F.2d 147, 152-53 (10th Cir. 1980),

involving the interpretation of statutes enacted twelve years apart, that the latter act " . . . reflects an interpretation of the earlier act and is entitled to great weight".

The majority opinion in the Court of Appeals refused to consider the legislative history of the 1986 TRA in its construction of the 1976 amendment of the Naval Appropriation Act.

> "We note that the district court's conclusion that the surtax is of a local nature is based solely on language appearing in a Senate Finance Committee report, written more than nine years after the surtax was authorized by Congress . . . and makes for a slender reed upon which to hang the outcome of this case". (App. 1 at pages App. 13-14.)

The Court of Appeals apparently believed that the time passing between the statutes was sufficient to negate the weight to be given to the subsequent action of Congress. This is contrary to the principal of statutory construction set forth by this Court in *United States v. Stewart*, supra, *Regents of University of California v. Bakke*, supra, and *Red Lion Broadcasting v. FCC*, supra, and contrary to the principals set forth by the Tenth Circuit Court of Appeals in *James v. Ford Motor Credit Co.*, supra.

The language in the legislative history of the 1986 TRA must be regarded as a legislative interpretation of the earlier act in that it aids in ascertaining the meaning of the words as used in their contemporary setting. It must, therefore, be given great weight in determining the intent of Congress in enacting the 1976 amendment to the Naval Appropriation Act. Section 1274(b) of the 1986 TRA states that any tax imposed " . . . shall be treated in the same manner as State and local income taxes under

section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies." The Surtax imposed by the Virgin Islands Legislature pursuant to authority granted to it by the Congress in the 1976 amendment to the Naval Appropriation Act must also be deductible.

THE THIRD CIRCUIT COURT OF APPEALS SUBSTITUTED ITS OWN JUDGMENT FOR THAT OF CONGRESS IN CONSTRUING 48 U.S.C. § 1397, AS IT RELATES TO SECTION 164 OF THE INTERNAL REVENUE CODE, AND JUDICIALLY LEGISLATED A RESULT NOT INTENDED BY CONGRESS, WHICH CONFLICTS WITH THE DECISIONS OF THIS COURT IN *62 CASES, MORE OR LESS, EACH CONTAINING SIX JARS OF JAM V. UNITED STATES, EBERT V. POSTON* AND *BADARACCO V. COMMISSIONER.*

The second rationale of the Appellate Court, that the Respondents " . . . could never realize the full 10% Surtax allowed by Congress . . . " (App. 1 at page App. 12) is not supported by the language of the 1976 amendment to the Naval Appropriation Act or by legislative history. The Naval Appropriation Act provides, in pertinent part, that:

> " . . . the Legislature of the Virgin Islands is authorized to levy a Surtax on all taxpayers in an amount **not to exceed** 10 per centum of their annual income tax obligation to the government of the Virgin Islands." 48 U.S.C. § 1397 (emphasis added).

Congress did not state that the Surtax would be equal to 10%, but rather that the Surtax could not exceed 10%. Congress simply provided a method of taxation. Congress did not state that the Virgin Islands should receive

the full economic impact of a 10% Surtax. To the contrary, by setting a ceiling on the rate of the Surtax at 10%, Congress clearly contemplated that the tax rate, and thus the economic impact, could be less than the full 10%. Review of the legislative history of the 1976 amendment to the Naval Appropriation Act does not reveal that any discussion or consideration was given to the amount of revenue the Virgin Islands should receive through the Surtax. The discussions in the Committee Reports simply indicate that the Virgin Islands was experiencing a shortfall in its revenue as a result of the Tax Reduction Act of 1975 and desired the ability to raise revenue in addition to that generated by the mirror tax system to offset the shortfall. *See* the prepared statement of the Honorable Cyril E. King, Governor of the Virgin Islands, before the Senate Committee, *A Bill to Authorize Loan Funds for the Government of the Virgin Islands, and for Other Purposes*: Hearing before the U.S. Senate Comm. on Interior and Insular Affairs, 94th Cong., 2nd Sess. on S. 3357, pages 21-24. *See also* H.R. Comm. Rep. No. 94-1080 on H.R. 13359 and S. Rep. No. 94-1021 on H.R. 13359. There was no discussion regarding why the Surtax method of taxation was chosen by Congress or why the ceiling on the Surtax was set at 10%. *See also* the dissenting opinion filed by Circuit Judge Greenberg at page App. 17 of App. 1, wherein he states:

> "We simply cannot say from the statute or the legislative history, whether Congress wanted the Virgin Islands to accomplish a full 10% revenue enhancement through the surtax, or whether Congress was satisfied to authorize some lesser percentage of revenue enhancement".

By determining that the Virgin Islands should receive the full economic impact of the maximum Surtax rate, the Third Circuit Court of Appeals substituted its judgment for that of Congress and judicially legislated a result not intended by Congress. This effort violates the principle set out by this Court in *62 Cases, More or Less, Each Containing Six Jars of Jam v. United States*, 340 U.S. 593, 596 (1951), wherein this Court stated "[t]he Court cannot add, subtract, delete or distort words used [in a statute]." This Court stated in *Badaracco v. Commissioner*, 464 U.S. 386, 396 (1984) that "Courts are not authorized to rewrite a statute because they might deem its effect susceptible of improvement." *See also Ebert v. Poston*, 266 U.S. 548, 554 (1925), wherein the Supreme Court stated that:

> "The judicial function to be exercised in construing a statute is limited to ascertaining the intention of the Legislature therein expressed. **A casus omissus does not justify judicial legislation.**" (Emphasis added).

The majority of the Third Circuit Court of Appeals has taken it upon itself to provide that the Virgin Islands government should receive the full benefit of the Surtax imposed by the Virgin Islands Legislature. In doing so, the majority opinion stated that:

> "Imposing a high initial rate of income tax only to reduce it by permitting a deduction for the payment of that same tax is illogical and defeats the **Virgin Islands' legislative intent** of obtaining the maximum surtax percentage of 10% permitted under 48 U.S.C. § 1397." (Emphasis added). (App. 1 at App. 12.)

It should be noted that there is no evidence of the intent of the Virgin Islands Legislature in enacting the Surtax. Nonetheless, the intent of the Virgin Islands Legislature is immaterial. The Court must determine the intent of Congress in permitting the Virgin Islands Legislature to enact the Surtax and then interpret the statute to carry out that intent. The Court should not consider the intent of the Virgin Islands Legislature.

As a result of the 1986 TRA, the Virgin Islands Legislature may enact any nondiscriminatory local income tax. Any such tax " . . . will be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954." *Tax Reform Act of 1986* § 1274(b). Such a tax could be in the form of a surtax on income. In that case, the Virgin Islands would not receive the full surtax percentage imposed since the surtax would be deductible from income. Contrary to the statement of the Third Circuit Court of Appeals that such a result would be " . . . illogical . . . ", the result conforms to the stated intention of Congress.

The finding of the Third Circuit Court of Appeals is contrary to the intent of Congress and constitutes a judicial abuse of power by adding language to the statute not intended by Congress.

THE FAILURE BY THE THIRD CIRCUIT COURT OF APPEALS TO CONSIDER ALL OF THE WORDING OF SECTION 1397 OF THE NAVAL SERVICE APPROPRIATION ACT OF 1922 IN ITS CONSTRUCTION OF A PORTION OF THAT STATUTE CONFLICTS WITH THE DECISIONS OF THIS COURT IN *UNITED STATES V. NORDIC VILLAGE, INC.*, AND *COLANTTI V. FRANKLIN.*

The interpretation of the 1976 amendment to the Naval Appropriation Act by the Third Circuit Court of Appeals ignores other wording of the statute that:

> "The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States . . . " 48 U.S.C. § 1397.

One of the income-tax laws " . . . in force in the United States of America . . . ", as set forth in Naval Appropriation Act § 1397, and therefore incorporated by reference into that statute, is Internal Revenue Code § 164. This Court has stated in *United States v. Nordic Village, Inc.*, 112 S.Ct. 1011, 1015 (1992) that:

> ". . . a statute must, if possible, be construed in such a fashion that every word has some operative effect."

See also Colantti v. Franklin, 439 U.S. 379, 392 (1979), wherein the Court stated that:

> ". . . a statute shall be interpreted so as not to render one part inoperative."

The decision of the Third Circuit Court of Appeals does not give effect to Internal Revenue Code § 164 as

required by the language of Naval Appropriation Act § 1397, but rather focuses on only a portion of the statute.

CONCLUSION

The Third Circuit Court of Appeals failed to apply proper statutory construction principles as set forth by this Court in its determination that the Surtax imposed by the Virgin Islands Legislature was not deductible under Internal Revenue Code § 164. Ignoring a subsequent interpretation by Congress of its intent in enacting the 1976 amendment to the Naval Appropriation Act, the Third Circuit Court of Appeals substituted its own judgment for that of Congress and abused its discretion by judicially legislating an interpretation of the statute not intended by Congress. This is an egregious decision which may be corrected only by this Court inasmuch as the only jurisdiction this issue will arise in is the Third Circuit Court of Appeals. Unlike issues involving other areas of federal tax law, there are no alternative Courts, including the Tax Court, where this issue may again be heard.

This Petition for Writ of Certiorari to review the decision of the Third Circuit Court of Appeals should be granted.

Dated the 17th day of September, 1993.

Respectfully submitted,

ABRAMSON ENTERPRISES, INC.,
Petitioner

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APPENDIX 1

Filed May 28, 1993

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 92-7381

ABRAMSON ENTERPRISES, INC.

v.

GOVERNMENT OF THE VIRGIN ISLANDS
of the UNITED STATES; ANTHONY OLIVE,
Director, V.I. Bureau of Internal Revenue

(Civil No. 89-00112)

ABRAMSON ENTERPRISES, INC.

v.

GOVERNMENT OF THE V.I. of U.S.; EDWARD
THOMAS, Director, V.I. BUREAU OF INTERNAL
REVENUE; ALEXANDER FARRELLY, GOVERNOR OF
THE UNITED STATES VIRGIN ISLANDS

(Civil No. 91-00289)

Edward E. Thomas, Director
as named defendant in No.
1991-289 and as successor
in office in No. 1989-112,
Virgin Islands Bureau of
Internal Revenue,
Appellant

On Appeal from the District Court
of the Virgin Islands

(D.C. Nos. 89-00112 and 89-00289)

Argued Monday, April 26, 1993

BEFORE: GREENBERG, SCIRICA and GARTH,
Circuit Judges

(Opinion filed May 28, 1993)

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OPINION OF THE COURT

GARTH, *Circuit Judge*:

This appeal concerns the narrow question of whether the corporate surtax imposed on Virgin Islands taxpayers pursuant to V.I.Code Ann. tit. 33, § 581 (Supp. 1990) ("§ 581") is deductible from Virgin Islands taxable income under § 164 of the Internal Revenue Code ("§ 164") as applied to the Virgin Islands under the "mirror system" of taxation. We conclude that the surtax is non-deductible and, accordingly, we will reverse the judgment of the district court and direct that judgment be entered in favor of the Virgin Islands Bureau of Internal Revenue.

I.

The relevant facts are not in dispute. The instant appeal encompasses two related actions, consolidated below, which arose when appellants, Virgin Islands Bureau of Internal Revenue and its Directors of record for the relevant periods (collectively, "VIBIR"), assessed tax deficiencies against appellee, Abramson Enterprises, Inc. ("Abramson"), for the years 1986, 1987 and 1988. Abramson had paid the 10% corporate surtax on income imposed by the Virgin Islands and had then deducted the amount of the surtax from its Virgin Islands taxable income.

As the disposition of the case unfolded, the district court first heard the case involving Abramson's 1986

return and issued a memorandum opinion holding that the surtax was not deductible. However, on consideration of the alleged deficiencies for tax years 1987 and 1988, the district court reconsidered the 1986 case as well. After a bench trial, the district court retracted its earlier conclusion and, in a Memorandum and Order dated March 23, 1992, held that the corporate surtax imposed by the Virgin Islands *is* deductible from the taxable income of Virgin Islands corporations. The district court therefore concluded that the notices of deficiency, to the extent that they were related to Abramson's deductions of corporate surtax for the tax years 1986-88, were invalid. VIBIR appeals that decision.

II.

All facts giving rise to this appeal were stipulated by the parties, and because our holding turns only on a matter of law, our review of the district court's order of March 23, 1992 is plenary. We preface our review with a brief discussion of the relevant statutory framework. The Internal Revenue Code of the United States is made applicable to the Virgin Islands pursuant to the Naval Service Appropriation Act of 1922, 48 U.S.C.A. § 1397 (1987):

> The income-tax laws in force in the United States of America and those which may hereinafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands. . . .

Id.

The result of this statute has been to create a "mirror system" of taxation under which Virgin Islands residents discharge their United States tax liability by paying all income taxes directly to the Treasury of the Virgin Islands. The "mirror system" has been applied through rules of construction promulgated by the Internal Revenue Service, VIBIR and the courts. These rules were summarized by this court in *Johnson v. Quinn*, 821 F.2d 212 (3d Cir. 1987):

> The Internal Revenue Service has stated that in construing the IRC as in force in the Virgin Islands it is "necessary in some sections of the law to substitute the words 'Virgin Islands' for the words 'United States' in order to give the law proper effect.". . . . In *Sayre & Co. v. Riddell*, 395 F.2d 407 (9th Cir. 1968), a case cited with approval by this circuit . . . the court, construing Guam's comparable mirror code, noted Congress's codification of the word substitution rule in 42 U.S.C. § 1421(e), which states that "except where it is manifestly otherwise required, the applicable provisions of the Internal Revenue Code . . . shall be read so as to substitute 'Guam' for 'United States.' " 395 F.2d at 412-13.
>
> *Id.* at 214.

As the law has developed under the mirror system, the provisions of the Internal Revenue Code are applicable to the Virgin Islands so long as the specific section to be applied is not "manifestly inapplicable or incompatible with a separate territorial income tax." *Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973, 976 (3d Cir. 1970) (citations omitted). Moreover, under the "equality principle" discussed in *Johnson v. Quinn*, 821 F.2d 212 (3d Cir.

1987), " '[t]he tax to be paid [to the Virgin Islands] ordinarily is measured by the amount of income tax the taxpayer would be required to pay to the United States of America if the taxpayer were residing in the continental United States.' " *Id.* at 214 (*quoting Chicago Bridge*, 430 F.2d at 975-76).

III.

A.

The instant case concerns the applicability of I.R.C. § 164 to income tax paid by Virgin Islands corporations to VIBIR. Section 164(a)(3) states:

> Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:
>
> . . .
>
> State and local . . . taxes.

I.R.C. § 164(a)(3) (West Supp. 1993). Section 164(b)(2) defines a "state or local tax" as:

> . . . a tax imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia.

I.R.C. § 164(b)(2) (West Supp. 1993).

The applicability of § 164 to Virgin Islands taxpayers is presently being challenged as a result of a corporate surcharge that the Virgin Islands has levied against corporations over and above taxes due under the Internal Revenue Code. This surcharge was first authorized in

1976 when, in order to compensate the Virgin Islands for expected lost revenues due to the Tax Reduction Act of 1975, Congress amended 48 U.S.C. § 1397 to allow the Virgin Islands legislature to impose a surtax of up to 10% on federal income taxes, payable to the treasury of the Virgin Islands. The new language read in pertinent part: " . . . notwithstanding any other provision of law, the Legislature of the Virgin Islands is authorized to levy a surtax on all taxpayers in an amount not to exceed 10 per centum of their annual tax obligation to the government of the Virgin Islands." 48 U.S.C.A. § 1397 (1987).

The Virgin Islands legislature, however, chose not to take advantage of its newfound taxing authority until ten years later when it imposed a 10% corporate surtax:

> There is hereby imposed on all corporations that have a liability to pay Virgin Islands income tax a surcharge of ten percent (10%) of each such corporation's total income tax liability, defined as "Total Tax Liability.". . . .

33 V.I.C. § 581(a) (Supp. 1990).

Relying on the "equality principle" articulated in *Johnson, see supra* typescript at 4, Abramson asserts that § 164 must also apply to the corporate surtax paid by a Virgin Islands taxpayer in order to impose on that taxpayer a tax obligation equivalent to one for which a United States taxpayer would be responsible. Abramson argues:

> The Surtax is equivalent to an income tax enacted by a state legislature since it was enacted by the Virgin Islands legislature pursuant to authority granted it by the Congress. If [Abramson] was an United States taxpayer and

> had paid the Surtax to [VIBIR], there is no doubt that it would be entitled to a deduction for the tax under Internal Revenue Code § 164.

Abramson's Brief at 11.[1]

Although Abramson does not dispute that the surtax in question was imposed pursuant to the authority granted the Virgin Islands in 1976 under § 1397, Abramson nevertheless looks to the legislative history of the Tax Reduction Act of 1986 ("TRA") in order to support its contention that the surtax is deductible pursuant to § 164. Enacted in 1986 after the surtax had been implemented by the Virgin Islands Legislature, TRA § 1274(b) amends 26 U.S.C. § 932 and allows the Virgin Islands to impose local income taxes without regard to the 10% limitation imposed under § 1397:

> (b) Authority to impose nondiscriminatory local income taxes. – Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 [section 164 of this title] and shall not be treated as taxes to which section 901 of such Code [section 901 of this title] applies.

---

[1] There can be little doubt that if Abramson was a United States taxpayer it could under § 164 deduct the Virgin Islands surtax just as it could deduct any other state tax that had been imposed. Here, however, Abramson is not a United States taxpayer, but is rather a Virgin Islands taxpayer seeking to deduct a Virgin Islands surtax from its Virgin Islands taxable income.

TRA § 1274(b) of Pub.L. 99-514, as amended Pub.L. 100-647, Title I, § 1012(w)(4), Nov. 10, 1988, 102 stat. 3530.[2]

In addition to the authority it grants the Virgin Islands to implement "nondiscriminatory local income taxes," Abramson asserts that, on its face, the language of § 1274 (b) mandates that any corporate surtax imposed by the Virgin Islands must be deductible as a "state or local tax."[3] In fact, Abramson insists that even were we to hold that the nature of the surtax (local or federal) is ambiguous in the context of the relevant statutory language, an examination of the legislative history surrounding the enactment of § 1274(b) evinces Congress' intent that the surtax, which had been authorized ten years earlier, be treated as a local tax for purposes of § 164. The district court agreed:

> [Abramson's] key piece of evidence . . . is the Senate Finance Committee's Report on the TRA. The report is devoted primarily to a discussion of the substantive changes in § 932 [and] provides a thorough review of the state of the Virgin Islands' tax laws at the time, and an explanation of the effect of the proposed changes in the TRA. The Senate Finance Committee said the following about the surtax permitted by the 1976 amendment of § 1397:

---

[2] I.R.C. § 901 pertains to foreign tax credits and has no relevance in the context of this appeal.

[3] We stress that our opinion today considers and addresses only the deductibility of the *income* surtax imposed by the Virgin Islands on Virgin Islands taxpayers and does not address any other type of tax that might be imposed by the Virgin Islands Legislature.

> The Virgin Islands is authorized to impose up to 10-percent surtax on the mirror system tax. Otherwise, the Virgin Islands does not have the power to impose local taxes on income.

Committee Report at 477.

District Court's Order of June 8, 1992 at 2-3 (modifying its memorandum of March 23, 1992) (A120-21).

In regard to the above-cited Senate Finance Committee report, the district court observed, "I understand this statement to mean that the Senate Finance Committee believed that the surtax permitted by the 1976 amendment to § 1397 was a local tax on income, or a local income tax." *Id.* at 3. On the strength of the Committee's statement, the district court held for Abramson, concluding that § 164 is applicable to the corporate surtax at issue, and that therefore the Virgin Islands surtax paid by Abramson was properly deducted from Abramson's Virgin Islands income.

B.

Before making any determination as to whether the surtax is of a "local" nature as contemplated by § 164, it is first necessary to determine whether § 164 is applicable to the instant case. For, if § 164, which provides for the deductibility of state and local taxes, is not operable in the context of the instant case, then styling or labeling the surtax as "local" rather than "federal" would be immaterial to the instant appeal since, in either case, no deduction from Virgin Islands taxable income would be permitted.

Claiming that it should pay no more to the Virgin Islands than a similarly situated United States taxpayer would pay to the United States, Abramson argues that the "equality principle" as discussed in *Johnson* should control the outcome of this case. We reject Abramson's argument, even though we accept its proposition that if the Virgin Islands were a state whose citizens paid federal taxes to the IRS rather than to VIBIR, the Virgin Islands surtax on corporate income would be deductible from the taxpayer's federal taxable income pursuant to § 164.

Abramson's analogy is inapposite precisely because the Territory of the Virgin Islands is not a state and its citizens do not pay taxes to the IRS. Rather, the surtax at issue is payable into the very same coffers – those of the Virgin Islands – that receive the income tax payments that Abramson seeks to diminish through the deductions at issue.

Under the federal system, state income tax may logically be deductible from taxable income for federal purposes since state and federal governments are separate and discrete entities. In the case at hand, however, Abramson seeks to deduct from its Virgin Islands taxable income (the tax on which is paid directly to VIBIR) a surtax on its income that is also paid directly to VIBIR. The district court would permit such a deduction. Our analysis will not.

That is not to say that the Territory of the Virgin Islands (or even a state) is constitutionally or statutorily

barred from providing for such a deduction.[4] Surely if the Territory wished to lower its effective rate of income taxation, it could do so simply by lowering the direct rates at which it taxes income. Imposing a high initial rate of income tax only to reduce it by permitting a deduction for the payment of that same tax is illogical and defeats the Virgin Islands' legislative intent of obtaining the maximum surtax percentage of 10% permitted under 48 U.S.C. § 1397.

In further support of our conclusion, we note that § 1397 authorizes VIBIR to levy up to a 10% surtax on income. Yet, under the scheme proposed by the district court, VIBIR could never realize the full 10% surtax allowed by Congress because deductions taken pursuant to § 164 would reduce the effective rate of the Virgin Islands surtax to a level below 10%.[5] Thus, application of § 164 to the instant case would not only defy rationality but would serve to frustrate Congress' stated intention of allowing the Virgin Islands to levy a full 10% surtax on income.

---

[4] As demonstrated at oral argument, the taxing scheme which would result from the district court's holding is not, as suggested in VIBIR's brief, mathematically unachievable. However, it is readily apparent, as we point out in text, *infra*, that under Abramson's theory the Virgin Islands could never succeed in obtaining a full 10% increase in corporate income tax unless it increased the percentage of the corporate surtax to take into account the deduction claimed by the taxpayer – an action prohibited by the ceiling once imposed by § 1397.

[5] Although the exact percentage would vary depending on the circumstances of any particular taxpayer, the effective rate of the surtax would always remain at a level below 10%.

Although state and federal taxing schemes are necessarily complex and more than occasionally convoluted, we can think of no circumstance (and the parties could not advise us of one) in which income tax paid to a discrete taxing authority may be reduced by the amount of a payment of the same tax to the self-same authority.[6] If we were persuaded to apply § 164 to the surtax at issue here, assuming that surtax was in truth a tax that could be deducted, such an application of § 164 could only evoke illogical consequences.

The court in *Chicago Bridge,* 430 F.2d at 976, noted that incorporation of the Internal Revenue Code in the Virgin Islands is limited to those provisions that are "not manifestly inapplicable or incompatible with a separate territorial income tax." *Id.* Because its application would offend the very concept of an orderly and rational system of taxation, we believe that § 164 is fundamentally inapplicable to the present facts. We therefore hold that the "mirror system" will not allow the application of § 164 to the claimed deductions giving rise to this appeal.

C.

Having reached the conclusion that § 164 is inapplicable, we need not dwell at length upon the district court's holding that Congress intended the surtax to be a "local" tax. We note that the district court's conclusion

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[6] VIBIR calls our attention to I.R.C. § 275 which prohibits the deduction of federal income taxes from federal taxable income and argues that under the "mirror system" no deduction of the Virgin Islands corporate surtax from taxable income may be permitted.

that the surtax is of a local nature is based solely on language appearing in a Senate Finance Committee report, written more than nine years after the surtax was authorized by Congress, *see supra* typescript at 7-8, and makes for a slender reed upon which to hang the outcome of this case. Whatever meaning the Senate Report may have attributed to the term "local," a term that it did not define, there is simply no evidence that the Senate Committee intended its report to provide for the deductibility under I.R.C. § 164 of a Virgin Islands imposed income surtax from Virgin Islands taxable income.

The mere fact that the Virgin Islands surtax may be labeled a "local" tax because it was enacted by the Virgin Islands legislature does not mean that its styling as "local" carries the import and baggage of a local tax as contemplated by § 164. Rather, because the corporate surtax is a tax on income authorized by Congress it has a federal quality that other taxes imposed by the Virgin Islands legislature may not share. Those other taxes, if they are of the "local" character, may, as we have pointed out, be deductible. But for the reasons we have expressed, a surtax on income which reduces the overall tax imposed by the same taxing authority cannot be styled a "local" tax for purposes of § 164. Thus, even had we not held § 164 inapplicable in the instant case, we would have been disposed to reach the same result based on the nature of the surtax involved here.

IV.

We will therefore reverse the judgment of the district court and direct the district court to enter judgment for VIBIR.

GREENBERG, *Circuit Judge,* dissenting.

As is clear from my departure from the majority's view and from the district court's change of position over the course of this litigation, reasonable minds can differ – indeed, the same reasonable mind can be in doubt – as to whether the Virgin Islands corporate surtax is a "local" tax within the meaning of 26 U.S.C. § 164. Because I believe the surtax is such a local tax, I would affirm the district court's holding that Abramson Enterprises may deduct the surtax from its taxable income for the years 1986, 1987 and 1988.

To place the issue in a practical perspective, I would note that while Congress authorized the 10% surtax to replace Virgin Islands revenues which might have been lost due to the Tax Reduction Act of 1975, Congress subsequently has given the Virgin Islands legislature broader authority to enact a local income tax in any amount the territorial legislature may find necessary. *See* Tax Reform Act of 1986, P.L. 99-514, Section 1274(b). Apparently the Virgin Islands legislature has not enacted any taxes as authorized under the Tax Reform Act of 1986, but continues to rely on the 10% corporate surtax enacted pursuant to 48 U.S.C. § 1397. However, it is clear that in the event the deductibility of the surtax would impair Virgin Islands tax revenues significantly, the territorial legislature is empowered to replace or augment the

surtax by enacting a new local income tax pursuant to Section 1274(b) of the Tax Reform Act.

One of the majority's chief reasons for finding the surtax nondeductible is that "because the corporate surtax is a tax on income authorized by Congress it has a federal quality that other taxes imposed by the Virgin Islands legislature may not share." [*Supra*, typescript at 11.] The hesitant "may not" reveals the crux of my disagreement, because in fact *all* taxes imposed by the Virgin Islands legislature must be authorized by Congress, and therefore all such taxes *do* share, necessarily, the "federal quality" of the surtax. While I would agree that one cannot reverse-engineer the "local" nature of the surtax from the text or the legislative history of the subsequent Tax Reform Act of 1986, I would point out that Section 1274(b) of the Tax Reform Act is identical to 48 U.S.C. § 1397 insofar as each is a Congressional *authorization* for the Virgin Islands legislature to enact taxes. In neither case does the tax actually arise unless the territorial legislature itself enacts the tax that is only permitted, and not imposed, by the act of Congress. The Virgin Islands income tax permitted under the Tax Reform Act is, as the majority notes, decidedly deductible by its very terms under I.R.C. § 164. Thus, the corporate surtax does not have any "federal quality" in its structure which the clearly deductible tax of Section 1274(b) does not share. While Section 1274(b) does not in itself "prove" that the earlier surtax should be deductible, it certainly establishes that congressional authorization – which is necessary for virtually any act of the Virgin Islands legislature – does not render the enactments of the territorial legislature any less "local" in character.

The second major point relied upon by the majority is that deductibility of the surtax would mean that the Virgin Islands could not get the full 10% enhancement of the stated maximum surtax rate. However, as Abramson argued explicitly to the district court (App. at 116-117), such partially offsetting effects appear elsewhere in the Internal Revenue Code. (See, *e.g.*, 26 U.S.C. § 401(c)(2)(A)(v), offsetting "earned income" by deductible pension contributions.) Therefore, the existence of offsetting effects in itself indicates nothing about congressional intent. We simply cannot say from the statute or the legislative history, whether Congress wanted the Virgin Islands to accomplish a full 10% revenue enhancement through the surtax, or whether Congress was satisfied to authorize some lesser percentage of revenue enhancement. As a practical matter, it is clear that the Virgin Islands legislature did not view a maximum enhancement as necessary, because it waited nearly 10 years to enact a surtax, and even then, levied the surtax only upon corporate income, and not, as it had been authorized to do by Congress, upon all income. If the complexity of the offset calculation is bothersome, this could easily be remedied by a regulation providing that a surtax paid in a given tax year is not to be deducted until the following tax year.

Altogether, I am persuaded by Abramson's argument that in this case, statutory construction is not much aided by legislative history (appellee's brief at 12), and the court should fall back on the plain language of the relevant statutes and the overall structure of the Virgin Islands taxing scheme. In this regard, I would conclude that the basic "mirror" tax of 48 U.S.C. § 1397, in place

since 1921, is a tax "federal" in character because it is imposed by Congress without further action by the Virgin Islands legislature. In contrast, the 10% surtax, added to Section 1397 in 1976, is, like the "local income tax" of Section 1274(b) of the Tax Reform Act of 1986, authorized by Congress but imposed only by an independent enactment of the territorial legislature. Therefore, I believe that the surtax is as much a "local" tax as a tax imposed by a state. I would hold that the surtax of 48 U.S.C. § 1397 is a deductible "local" tax within the meaning of 26 U.S.C. § 164.

A True Copy:
Teste:

Clerk of the United States Court of Appeals for the Third Circuit

APPENDIX 2

IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF SAINT CROIX

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	
GOVERNMENT OF THE VIRGIN ISLANDS OF THE UNITED STATES and ANTHONY P. OLIVE, Director of the VIRGIN ISLANDS BUREAU INTERNAL REVENUE	:	No. 1989/112

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	
EDWARD E. THOMAS, DIRECTOR VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE	:	No. 1991/289

ORDER

CAHN, J.

March 23, 1992

IT IS ORDERED that:

1) The above cases are hereby consolidated;

2) The tax deficiencies assessed by the Virgin Islands Bureau of Internal Revenue against Plaintiff for the years 1986, 1987, and 1988 are hereby declared invalid;

3) The corporate surtax paid pursuant to 33 V.I.C. § 581 (1991 supp.) is a deductible local income tax within

the meaning of those terms as set out in 26 U.S.C. § 164(b)(2) (1988).

BY THE COURT:

/s/ Edward N. Cahn
Edward N. Cahn, J.

ATTEST: ORINN ARNOLD
CLERK OF THE COURT

BY: /s/ Theresa D. Thomas
Deputy Clerk

APPENDIX 3

IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF SAINT CROIX

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	
GOVERNMENT OF THE VIRGIN ISLANDS OF THE UNITED STATES and ANTHONY P. OLIVE, Director of the VIRGIN ISLANDS BUREAU INTERNAL REVENUE	:	No. 1989/112

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	
EDWARD E. THOMAS, DIRECTOR VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE	:	No. 1991/289

MEMORANDUM

CAHN, J.

March 23, 1992

The two cases before me (which the parties agree should be consolidated) raise the identical legal issue. The plaintiff in both these cases, Abramson Enterprises, has challenged the Virgin Islands Bureau of Internal Revenue's ("VIBIR") determination that the Virgin Islands' corporate surtax on federal income tax (hereinafter "Surtax") is not deductible as a local tax under Internal Revenue code § 164 (26 U.S.C. § 164 (1988), hereinafter "§ 164"). Civ. No. 1989/112 concerns the deductibility of the Surtax paid by Plaintiff for fiscal year 1986, while Civ.

No. 1991/289 concerns the deductibility of the Surtax paid by Plaintiff for fiscal years 1987 and 1988. VIBIR has sent Plaintiff notices of deficiency for each of these years relating, in part, to Plaintiff's decision to deduct the Surtax it paid from its income tax calculations. In both cases Plaintiff is asking this court to declare these notices of deficiency invalid; since both cases raise identical issues, they will be consolidated and treated as a whole.

Both parties have stipulated as to the facts and asked for the bench to try the case. I conclude that VIBIR's denial of the deduction is in error and that the notices of deficiency, to the extent that they relate to Plaintiff's deduction of the corporate surtax, are invalid.

I. BACKGROUND

The following facts are not in dispute. These two actions arose when VIBIR assessed a tax deficiency against Plaintiff for the years 1986, 1987 and 1988. In its audit of each filing, VIBIR denied the deduction of the Surtax.[1] Plaintiff claims that the Surtax is deductible

---

[1] The Surtax is collected by the Virgin Islands Government pursuant to 33 V.I.C. § 581 (1991 supp.), which says:

> Income tax surcharge on corporations
>
> (a) There is hereby imposed on all corporations that have a liability to pay Virgin Islands income tax a surcharge of ten percent (10%) of each such corporation's total income tax liability, defined as "Total Tax Liability."
>
> . . .
>
> (c) This section shall apply to taxable years beginning after December 31, 1985.

Id. § 581(a) & (c).

because it is a "local" tax and is therefore deductible under § 164, which states that:

> Except as otherwise provided in this section,the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:
>
> . . .
>
> State and local, and foreign, income, war profits and excess profits taxes.

§ 164(a)(3). Section 164 goes on to define "state or local tax" to mean:

> [O]nly a tax imposed by a State, a possession of the United States, or a political subdivision of the foregoing, or by the District of Columbia.

§ 164(b)(2).

Except where specified by Congress, the Internal Revenue Code governs all tax disputes in the Virgin Islands. In the Naval Appropriations Act of 1922, Congress declared that the income tax laws of the United States are the income tax laws of the Virgin Islands, with the proceeds from the taxes to be paid into the treasury of the Virgin Islands, rather than the treasury of the United States.[2] Under the Naval Act, the Virgin Islands has an income tax system which "mirrors" the Internal Revenue Code. *See Chicago Bridge and Iron Company v. Wheatley*, 430

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[2] *See* Naval Appropriations Act of 1922, ch. 44, § 1, 42 Stat. 123 (codified as amended at 48 U.S.C. § 1397 (1987)) (hereinafter "Naval Act").

F.2d 973, 975 (3rd Cir. 1970).[3] Thus, under the mirror tax system, the words "Virgin Islands" are substituted –where appropriate– for the words "United States" in the Internal Revenue Code in order to determine a person or corporation's Virgin Islands income tax obligations.[4]

Plaintiff's argument is that since the Surtax is a local tax, and local taxes are deductible under the Internal Revenue Code, and the Internal Revenue Code is the tax code for the Virgin Islands, VIBIR should allow a Virgin Island corporation to deduct its Surtax. In a response to Plaintiff's Amended Motion for Partial Summary Judgment (hereinafter "Summary Judgment Motion") filed in Civ. No. 1989/112, Defendant's counsel offered two arguments in opposition to Plaintiff's reasoning: Counsel argued (1) that the proper application of the mirror system leads to the conclusion that the Surtax does not fall within § 164(b)(2); (2) that it is not clear that Congress intended the Surtax to be a local tax when it delegated to the Virgin Islands the discretion to impose the Surtax. See Memorandum Brief in Support of Defendant's Reply to Amended Motion for Partial Summary Judgment at pp. 2

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[3] Third Circuit Court of Appeals has held that:

> It "will, of course, be necessary in some sections of the law to substitute the words 'Virgin Islands' for the words 'United States,' in order to give the law proper effect in those islands."

Id. (quoting a 1935 ruling by the Bureau of Internal Revenue).

[4] *See, e.g., Vitco, Inc. v. Government of Virgin Islands*, 560 F.2d 180, 181 (3rd Cir. 1977) ("Congress provided that the provisions of United States income tax law should be used in the tax code of the Virgin Islands with necessary nomenclature changes to make them effective, that is, 'Virgin Islands' should be substituted for 'United States' whenever appropriate").

& 5. This court rejected the first argument but accepted that the second argument raised material factual issues requiring a decision by a factfinder.[5] Since I have already decided that a proper application of the mirror theory could permit the Surtax to be considered a local tax, the only question for me to decide today – as factfinder, and not in the context of a summary judgment motion – is whether the available evidence supports the conclusion that Congress intended the surtax it authorized the Virgin Islands to impose to be a local tax.

II. CONGRESSIONAL INTENT REVISITED

Since the time when I denied Plaintiff's Summary Judgment Motion, Plaintiff has filed a Motion for Reconsideration (in Civ. No. 1989/112) and filed a Brief in Support of Deductibility of Surtax, which I take to be a response to Defendant's Motion for Partial Summary

---

[5] Defendant argued that if one replaced the words "United States" with the words "Virgin Islands" as the mirror theory requires, one ends up with the following reading of § 164(b)(2):

> A State or local tax includes only a tax imposed by a State, a possession of the Virgin Islands, or a political subdivision of the foregoing. . . .

Of course, a reference in the mirror system to a "possession of the Virgin Islands" is nonsensical. I therefore held that Defendant's application of the mirror theory was inconsistent with the teachings of *Chicago Bridge* and *Vitco*, which instructs courts to replace the words "United States" with "Virgin Islands" where appropriate. *See Abramson Enterprises, Inc. v. Government of the Virgin Islands et. al.*, Civ. No. 1989/112 (D.V.I. August 15, 1991) at 7. Given the paucity of evidence as to Congressional intent, however, I accepted Defendants' second argument. *Id.* at 8-9.

Judgment filed in Civ. No. 1991/289. The additional pleadings in Civ. No. 1989/112 and Civ. No. 1991/289 introduce new information about the legislative history behind Congress's decision to allow the Virgin Islands to impose the Surtax that leads me to conclude, as factfinder in this consolidated case, that Congress intended the surtax it permitted the Virgin Islands to impose after 1975 to be considered a local tax, as defined by § 164(b)(2) of the Internal Revenue Code.

A. The 1976 Tax Authorization

In 1976 the Congress amended 48 U.S.C. § 1397 (1987) ("§ 1397") to allow the Virgin Islands legislature to impose a surtax of up to 10% on federal income taxes, payable to the treasury of the Virgin Islands. By amending § 1397, Congress, which had established the rule in the Naval Act that the Virgin Islands income tax laws were written by Congress and no one else, allowed, for the first time, an exception to the rule:

> That notwithstanding any other provision of law, the Legislature of the Virgin Islands is authorized to levy a surtax on all taxpayers in an amount not to exceed 10 per centum of their annual income tax obligation to the government of the Virgin Islands.

Id. Congress permitted the imposition of a surtax in order to permit the Virgin Islands to compensate for the Tax Reduction Act of 1975, which would, because of the mirror system, impose a mandatory reduction of income tax

revenues collected by the Virgin Islands.[6] The Virgin Island Legislature, however, did not take advantage of the surtax provision in § 1397 until they passed the Surtax in 1985.

B. The 1986 Tax Authorization

In 1986 the Congress again considered the question of the Virgin Islands' discretionary power to impose an income tax. This time, however, the object of the amending process was not § 1397, but 26 U.S.C. § 932 (1988) (the section of the Tax Code which deals with the "Treatment of United States and Virgin Island income taxes") (hereinafter "§ 932"), and the vehicle for the amendments was the Tax Reform Act of 1986, Pub.L. 99-514, § 1274(b), 100 Stat. 2085, 2597 (1986) (hereinafter "TRA"). The actual modification in the language of § 932 was minor and is unrelated to the question of whether the Surtax is a local tax.[7]

---

[6] The Senate Report on the 1976 surtax authorization states:

> The attached draft bill would deal with the effects of the Tax Reduction Acts and the deferred capital improvement projects. . . . This amendment would enable the Government of the Virgin Islands to respond to changes in the income tax laws of the United States.

S. Rep. No. 94-1021, p.8, 3 U.S. Code & Cong. & Adm. News 2104 (1976).

[7] Section 932 sets out the federal tax obligations of United States and Virgin Island residents. Section 1274(a) of the TRA enacted, in part, language which was codified as § 932(e) which stated:

(continued . . .)

In the course of debating and passing the TRA and the amendments to § 932, Congress reviewed its decision to grant the Virgin Islands the power to impose a surtax and voted to include the following language in the TRA.[8]

> Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code

---

> This section [932] shall not apply for purposes of determining income tax liability incurred to the Virgin Islands.

Id.

> In 1988 Congress further amended § 932(e) to read: Special rule applying section to tax imposed in Virgin Islands. – In applying this section for purposes of determining income tax liability incurred to the Virgin Islands, the provisions of this section shall not be affected by the provisions of Federal law referred to in section 934(a).

26 U.S.C. 932(e) (1991 supp.). Title 26 U.S.C. § 934(a) (1988) states that, according to the Naval Act, the Virgin Islands legislature cannot reduce or remit by any form of payment, the tax obligations owed it under the mirror system (except for income derived from within the Virgin Islands or connected with a trade or business within the Virgin Islands).

While this change of language certainly changes one aspect of § 932 (it now implicitly modifies the Naval Act), it obviously does not change the meaning of § 932 overall, and it certainly has no bearing on the question of whether Congress intended the surtax it permitted the Virgin Islands to impose to be a local tax.

[8] Section 1274(b) of the TRA was enacted on October 22, 1986 as an official session law, but was not incorporated into § 932.

> of 1954 [section 164 of this title] and shall not be treated as taxes to which section 901 of such Code [section 901 of this title] applies.

TRA § 1274(b).[9]

C. Do the Authorizations Reveal Different Intentions?

Defendant argues that the fact that in 1976 Congress did not refer to the tax which it allowed the Virgin Islands to impose as a local income tax, and that in 1986 Congress explicitly referred to this tax as a local income tax, proves that Congress did not intend that the tax it permitted the Virgin Islands to impose in 1976 was to be a local tax. This is a slender reed upon which to base an interpretation of Congressional intent. Since there is scant evidence about what Congress intended in 1976, both the Plaintiff and the Defendant have offered interpretations of what Congress thought it was affecting or changing when it revisited the surtax issue in 1986. Further examination of the record suggests that Defendant is misreading Congress's understanding of the 1976 legislation as expressed in the history of the 1986 enactments.

The Defendant argues that the following differences between the tax authorization found in the 1976 amendment to § 1397 and the 1986 amendment to § 932 suggest that Congress intended the latter (but not the former) to be a local tax as defined by § 164(c). First, the 1976

---

[9] The same language was adopted by Congress when it amended § 932 in 1988. *See* Pub.L. 100-647, Title I, § 1012(w)(4), 102 Stat. 3530 (1988).

amendment refers to the permitted tax as a "surcharge," while the 1986 amendment refers to a "local income tax." Second, the 1976 amendment sets a limit (10%) to the surtax that the Virgin Islands can impose, while the 1986 amendment is silent as to any cap. Finally, the 1976 amendment does not say whether the surtax is deductible under § 164(c), while the 1986 amendment clearly states that the local income tax is deductible. None of these three differences, singly or together, significantly support Defendant's conclusion. I turn, therefore, to Plaintiff's interpretation of Congress's intent in 1986.

The key piece of evidence Plaintiff directs to my attention is the Senate Finance Committee's report on the TRA.[10] The report is devoted primarily to a discussion of the substantive changes in § 932 indicated in n.7, *supra*. The Committee report provides a thorough review of the state of the Virgin Islands tax laws at the time, and an explanation of the effect of the proposed changes in the TRA. The Senate Finance Committee said the following about the surtax permitted by the 1976 amendment of § 932:

> The Virgin Islands is authorized to impose up to a 10-percent surtax on the mirror system tax. Otherwise, the Virgin islands [sic] does not have the power to impose local taxes on income.

Committee Report at 477. I understand this statement to mean that the Senate Finance Committee believed that the surtax permitted by the 1976 amendment to § 932 was

---

[10] Staff of Senate Finance Comm., 99th Cong., 2d Sess., Report on H.R. 3838, General Explanation (Comm. Print 1986) (hereinafter "Committee Report").

a local tax on income, or a local income tax. In oral argument in this case, Defendant argued that the word "[o]therwise" served to connect the first sentence in the quote above with the second sentence, instead of serving to contrast the two ideas in the quote; according to Defendant, in this quote, "otherwise" means "therefore." I reject Defendant's reading of the quote.

Furthermore, in the section of the Committee Report that explains the effect of the TRA's *new* provisions, the report adopts the future tense to discuss any changes in the status quo brought about by the TRA (*e.g.*, "Under the bill . . . the United States *will* be treated . . . " Committee Report at 482 (emphasis added)), and the present tense to discuss the status quo in 1986. It is important to note that the Committee Report says the following about the Virgin Islands' power to impose a "local income tax":

> The Virgin Islands *is* provided with authority to enact nondiscriminatory local income taxes (which for U.S. tax purposes would be treated as State or local income taxes) in addition to those imposed under the mirror system.

Id. at 483 (emphasis added). I find that the Senate Finance Committee, in 1986, believed that the surtax the Virgin Islands was permitted to impose after 1976 was a local income tax. I must therefore also find that the Senate Finance Committee believed, in 1986, that Congress, in 1976, intended that the surtax permitted by the 1976 amendment to § 932 was to be a local tax and deductible under § 164.

Proof of Congressional intent with regard to prior Congressional intent is not dispositive: the Committee

Report could be wrong about the intention of the 1976 Congress. There is another reason, however, to believe that the Senate Finance Committee's belief about Congress's intention in 1976 is correct. Defendant's position would have me ascribe to the 1976 Congress a somewhat unlikely intention. According to Defendant, when Congress chose to use the term "surtax" and to remain silent about deductibility in 1976, it intended to delegate to the Virgin Islands legislature the power to create a non-local income tax. Logic tells us that a non-local income tax is a federal income tax. I find it hard to believe that Congress intended – without more debate and perhaps even a discussion of the constitutionality of the proposed changes to the Naval Act – to delegate to another legislature the power to create a federal income tax at its discretion.[11]

---

[11] Section 932(e) and 26 U.S.C. § 934(a) & (b) (1988), when read in tandem, clearly grant to the Virgin Islands the power to reduce certain corporate or personal tax obligations to the Virgin Islands through reduction or remittal. Since income tax obligations in the Virgin Islands are governed by the Internal Revenue Code through the mirror system, it is clear that Congress has delegated to the Virgin Islands' legislature the power to *mitigate* the effects of the federal income tax laws. The power to create a federal income tax, over and beyond what Congress has mandated, and the power to mitigate the effects of that same system are two very different types of delegation, and although I need not reach this question in order to decide this case, I note that I am skeptical of the idea that Congress may delegate the power to create a federal income tax to a state or territorial legislature.

III. CONCLUSION

The corporate surtax imposed by the Virgin Islands Government pursuant to 33 V.I.C. § 581 (1991 supp.) has been imposed consistent with the authority to impose a local income tax delegated to the Virgin Islands by the United States Congress through 48 U.S.C. § 1397 (1987). The Surtax is a deductible local income tax within the meaning of those terms as set out in 26 U.S.C. § 164(b)(2) (1988). The notices of deficiency sent by VIBIR to Plaintiff for 1986, 1987, and 1988 are invalid.

An Order pursuant to this Memorandum will follow.

/s/ Edward N. Cahn

APPENDIX 4

IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF SAINT CROIX

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	No. 1989/112
GOVERNMENT OF THE VIRGIN ISLANDS OF THE UNITED STATES and ANTHONY P. OLIVE, Director of the VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE	:	

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	No. 1991/289
EDWARD E. THOMAS, DIRECTOR VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE	:	

ORDER

CAHN, J.

March 24, 1992

IT IS ORDERED that the Order of March 23, 1992 in this case is amended to read as follows:

IT IS ORDERED THAT:

1) The above cases are hereby consolidated;

2) The corporate surtax paid pursuant to 33 V.I.C. § 581 (1991 supp.) is a deductible local income tax within the meaning of those terms as set out in 26 U.S.C. § 164(b)(2)(1988);

3) Defendant is hereby ordered to recalculate the tax deficiencies assessed against Plaintiff for the years 1986, 1987, and 1988 so that any declared deficiency conforms with the decision of this court that the corporate surtax paid by Plaintiff is a deductable[sic] local income tax.

BY THE COURT:

/S/ Edward N. Cahn
Edward N. Cahn, J.

ATTEST: ORINN ARNOLD
CLERK OF THE COURT

By: /s/ Illegible
Deputy Clerk

APPENDIX 5

IN THE DISTRICT COURT OF THE VIRGIN ISLANDS
DIVISION OF SAINT CROIX

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	No. 1989/112
GOVERNMENT OF THE VIRGIN ISLANDS OF THE UNITED STATES and ANTHONY P. OLIVE, Director of the VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE	:	

ABRAMSON ENTERPRISES, INC.	:	Civil Action
v.	:	No. 1991/289
EDWARD E. THOMAS, DIRECTOR VIRGIN ISLANDS BUREAU OF INTERNAL REVENUE	:	

ORDER

CAHN, J.

June 8, 1992

AND NOW, this 8 day of June, 1992, upon consideration of the defendant the government of the Virgin Islands of the United State's Motion for Reconsideration and the plaintiff's response thereto, IT IS ORDERED that the motion is DENIED.

Furthermore, IT IS ORDERED that this court's Memorandum of March 23, 1992 in this case is MODIFIED as follows. The first full paragraph on page 10 and the first full paragraph on page 11 which read:

The key piece of evidence Plaintiff directs to my attention is the Senate Finance Committee's report on the TRA. The report is devoted primarily to a discussion of the substantive changes in § 932 indicated in n.7, *supra*. The Committee report provides a thorough review of the state of the Virgin Islands tax laws at the time, and an explanation of the effect of the proposed changes in the TRA. The Senate Finance Committee said the following about the surtax permitted by the 1976 amendment of § 932:

> The Virgin Islands is authorized to impose up to a 10-percent surtax on the mirror system tax. Otherwise, the Virgin islands[sic] does not have the power to impose local taxes on income.

Committee Report at 477. I understand this statement to mean that the Senate Finance Committee believed that the surtax permitted by the 1976 amendment to § 932 was a local tax on income, or a local income tax. In oral argument in this case, Defendant argued that the word "[o]therwise" served to connect the first sentence in the quote above with the second sentence, instead of serving to contrast the two ideas in the quote; according to Defendant, in this quote, "otherwise" means "therefore." I reject Defendant's reading of the quote.

Furthermore, in the section of the Committee Report that explains the effect of the TRA's *new* provisions, the report adopts the future tense to discuss the status quo brought about by the TRA (*e.g.*, "Under the bill . . . the United States *will* be treated . . . ," Committee Report at 482 (emphasis added)), and the present tense to

discuss the status quo in 1986. It is important to note that the Committee Report says the following about the Virgin Islands' power to impose a "local income tax":

> The Virgin Islands *is* provided with the authority to enact nondiscriminatory local income taxes (which for U.S. tax purposes would be treated as State or local income taxes) in addition to those imposed under the mirror system.

Id. at 483 (emphasis added). I find that the Senate Finance Committee, in 1985, believed that the surtax the Virgin Islands was permitted to impose after 1976 was a local income tax. I must therefore also find that the Senate Finance Committee believed, in 1986, that Congress, in 1976, intended that the surtax permitted by the 1976 amendment to § 932 was to be a local tax and deductible under § 164.

are to be replaced by the following paragraphs:

The key piece of evidence Plaintiff directs to my attention is the Senate Finance Committee's report on the TRA. The report is devoted primarily to a discussion of the substantive changes in § 932 indicated in n.7, *supra*. The Committee report provides a thorough review of the state of the Virgin Islands' tax laws at the time, and an explanation of the effect of the proposed changes in the TRA. The Senate Finance Committee said the following about the surtax permitted by the 1976 amendment of § 1397:

> The Virgin Islands is authorized to impose up to a 10-percent surtax on the mirror system tax. Otherwise, the Virgin Islands does

> not have the power to impose local taxes on income.

Committee Report at 477. I understand this statement to mean that the Senate Finance Committee believed that the surtax permitted by the 1976 amendment to § 1397 was a local tax on income, or a local income tax. In oral argument in this case, Defendant argued that the word "[o]therwise" served to connect the first sentence in the quote above with the second sentence, instead of serving to contrast the two ideas in the quote; according to Defendant, in this quote, "otherwise" means "therefore." I reject Defendant's reading of the quote.

I find that the Senate Finance Committee, in 1986, believed that the surtax the Virgin Islands was permitted to impose after 1976 was a local income tax. I must therefore also find that the Senate Finance Committee believed, in 1986, that Congress, in 1976, intended that the surtax permitted by the 1976 amendment to § 1397 was to be a local income tax and deductible under § 164.[1]

---

[1] Defendant's Memorandum Brief in Support Of Defendant's Motion for Reconsideration ("Defendant's Memorandum") does not raise any new arguments. It does, however, point out two errors made by this court in my discussion of legislative history.

First, I am grateful to Defendant for noting that I referred to the surtax as the "1976 amendment to § 932" (of the IRC) when of course I meant the "1976 amendment to § 1397" (of the Naval Act). *See* Defendant's Memorandum at 23 n.7.

Second, and of greater importance, Defendant argues that I misunderstood the meaning of the Senate Finance committee's use of the present tense in its discussion of § 1274(a) of Pub.L.

BY THE COURT:

/s/ Edward N. Cahn
Edward N. Cahn, J.

99-514 in S.Rept. No. 313, 99th Cong., 2nd Sess. (referred to in my Memorandum of March 23, 1992 as "Committee Report"). *See* Defendant's Memorandum at 20. I have reviewed the Committee Report and admit that Defendant is probably correct: No weight should be placed on the fact that the authors of the Committee Report changed tenses when discussing the provisions of Pub.L. 99-514 pertaining to the ability of the Virgin Islands legislature to impose a local income tax after 1986.

Unfortunately for the Defendant, however, the statement in the Committee Report relating to the *surtax* is clearly in the section of the report that describes the state of the law before 1986, and it clearly establishes that the authors of the Committee Report believed that the surtax passed in 1976 was a local income tax.

I have made the appropriate corrections in this order.

APPENDIX 6

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 92-7381

ABRAMSON ENTERPRISES, INC.

v.

GOVERNMENT OF THE VIRGIN ISLANDS
OF THE UNITED STATES;
ANTHONY OLIVE, Director,
V.I. Bureau of Internal Revenue

(Civil No. 89-00112)

ABRAMSON ENTERPRISES, INC.

v.

GOVERNMENT OF THE V.I. OF U.S.; EDWARD
THOMAS, Director, V.I. BUREAU OF INTERNAL
REVENUE; ALEXANDER FARRELLY, GOVERNOR OF
THE UNITED STATES VIRGIN ISLANDS

(Civil No. 91-00289)

(D.C. Civ. Nos. 89-00112 and 89-00289)

SUR PETITION FOR REHEARING

Present: SLOVITER, *Chief Judge*, BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, LEWIS and GARTH*, *Circuit Judges*

The petition for rehearing filed by appellee in the above-entitled case having been submitted to the judges who participated in the decision of this Court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular service not having voted for rehearing, the petition for rehearing by the panel and the court in banc, is denied.

BY THE COURT,
/s/ Illegible
Circuit Judge

* As to panel rehearing only.

APPENDIX 7

§ 1397. Income tax laws of the United States in force; payment of proceeds; levy of surtax on all taxpayers

The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands: *Provided further,* That, notwithstanding any other provision of law, the Legislature of the Virgin Islands is authorized to levy a surtax on all taxpayers in an amount not to exceed 10 per centum of their annual income tax obligation to the government of the Virgin Islands.

(July 12, 1921, ch 44, § 1, 42 Stat. 123; Aug. 19, 1976, P. L. 94-392, § 5, 90 Stat. 1195.)

APPENDIX 8

Sec. 164. Taxes.

(a) General rule.

Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) The environmental tax imposed by section 59A.

(5) The GST tax imposed on income distributions.

. . .

(b) Definitions and special rules.

For purposes of this section –

. . .

(2) State or local taxes. A State or local tax includes only a tax imposed by a State, a possession of the United States, or a political subdivision of any of the foregoing, or by the District of Columbia.

APPENDIX 9

SEC. 1274. COORDINATION OF UNITED STATES AND VIRGIN ISLANDS INCOME TAXES.

. . .

(b) AUTHORITY TO IMPOSE NONDISCRIMINATORY LOCAL INCOME TAXES. – Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies.

APPENDIX 10

33 V.I.C. § 581

§ 581. Income tax surcharge on corporations

(a) There is hereby imposed on all corporations that have a liability to pay Virgin Islands income tax a surcharge of ten percent (10%) of each such corporation's total income tax liability, defined as "Total Tax Liability."

. . .

APPENDIX 11

G. Tax Treatment of Possessions (Secs. 944 and 971-977 of the bill and secs. 32, 48, 63, 153, 246, 338, 864, 876, 881, 882, 931-936, 934A, 957, 1402, 1442, 6091, 7651, 7654, and 7655 of the Code)

Present Law

Overview

The income tax laws of the United States are in effect in Guam, the Commonwealth of the Northern Mariana Islands ("CNMI"), the U.S. Virgin Islands, and American Samoa as their local income tax systems. These jurisdictions are termed "possessions" of the United States for tax purposes. To transform the Internal Revenue Code of 1954, as amended ("the Code"), into a local tax code, each possession, in effect, substitutes its name for the name "United States" where appropriate in the Code. The possessions generally are treated as foreign countries for U.S. tax purposes. Similarly, the United States generally is treated as a foreign country for purposes of possessions taxation. Although this word-substitution system, known as the "mirror system", applies to Guam, the CNMI, the Virgin Islands, and American Samoa, the U.S. tax relationship with each possession is governed by somewhat different rules, as described below.

. . .

Virgin Islands

Under the Naval Appropriations Act of 1922, the income tax laws of the United States, as amended, are held to be "likewise in force in the Virgin Islands", except

that the proceeds of the income tax are paid into the treasury of the Virgin Islands. The courts have interpreted this provision to establish a mirror system of taxation in the Virgin Islands.

. . .

The Virgin Islands is authorized to impose up to a 10-percent surtax on the mirror system tax. Otherwise, the Virgin Islands does not have the power to impose local taxes on income.

. . .

Reasons for Change

The Internal Revenue Code, with all its complexities, is designed primarily to tax income in the highly developed U.S. economy. The mirror system, which entails imposing the Code in its entirety as local law, may be wholly inappropriate for the island economies of the U.S. possessions. The possessions need tax systems that help them to pursue development policies and to exercise greater control over their own economic welfare.

. . .

Therefore, to promote fiscal autonomy of the possessions, it is important to permit each possession to develop a tax system that is suited to its own revenue needs and administrative resources.

. . .

Explanation of Provisions

Overview

The bill eliminates the requirement that there be a mirror system of taxation in Guam and the CNMI, coordinates the tax systems of those possessions and of American Samoa with the U.S. tax system, and reforms the mirror system in the Virgin Islands. The treatment of the Virgin Islands reflects extended discussions between representatives of the Virgin Islands and the Treasury. It differs from the treatment of the other possessions because of the unique history of the relationship between the Virgin Islands and the United States.

. . .

The Virgin Islands is provided with authority to enact nondiscriminatory local income taxes (which for U.S. tax purposes would be treated as State or local income taxes) in addition to those imposed under the mirror system.

. . .

No. 93-448

In The

Supreme Court of the United States

October Term, 1993

ABRAMSON ENTERPRISES, INC.,

Petitioner,

v.

EDWARD E. THOMAS, Director,
Virgin Islands Bureau of Internal Revenue,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals below erred in its determination that the ten-percent surtax imposed by the Virgin Islands pursuant to 33 V.I. Code § 581 is not a deductible State and local income tax for purposes of section 164(a) of the Internal Revenue Code as such Code applies in the Virgin Islands by reason of chapter 44, § 1, of the Naval Service Appropriation Act of 1922.

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No. 93-448

In The

Supreme Court of the United States

October Term, 1993

ABRAMSON ENTERPRISES, INC.,

Petitioner,

v.

EDWARD E. THOMAS, Director,
Virgin Islands Bureau of Internal Revenue,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION

Respondent opposes the Petition for a Writ of Certiorari. The Petition raises no issue worthy of review by this Court.

Respondent does not challenge Petitioner's assertions under the headings List of Parties, Opinions Below, Statement of Jurisdiction, and Statutes Involved. Respondent does challenge Petitioner's Questions Presented and portions of Petitioner's Statement of the Case. Therefore, Respondent has restated the Questions Presented and submits its own Statement of the Case.

STATEMENT OF THE CASE

Respondent generally agrees with the factual portion of Petitioner's Statement of the Case.[1] Respondent believes, however, that Petitioner has misstated the applicable law. Accordingly, this statement is provided.

The statute establishing the territorial income tax system in the Virgin Islands is § 1 of chapter 44 of the Naval Service Appropriation Act of 1922 (codified, as amended, at 48 U.S.C.A. § 1397), which states, in pertinent part:

> The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands. . . .[2]

In 1935, the Internal Revenue Service interpreted this provision as establishing what is known as the "mirror system" of taxation, under which the income tax law applicable in the Virgin Islands is a so-called "mirror image" of the Internal Revenue Code, *i.e.*, a code in which

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[1] The factual portion of Petitioner's Statement of the Case begins with the third full paragraph on page four of the Petition and ends with the carryover paragraph on page six of the Petition.

[2] The statutory provision codified at 48 U.S.C.A. § 1642, quoted in part by Petitioner (*see* Petition, at p. 2), requires Virgin Islands inhabitants to remit their *United States* income tax liabilities to the Virgin Islands Treasury, *see Danbury, Inc. v. Olive*, 820 F.2d 618 (3d Cir. 1987), *cert. denied*, 484 U.S. 964 (1987), and has no bearing on this case. Moreover, that provision was repealed by P.L. 99-514, § 1275(b), 100 Stat. 2598.

the Virgin Islands stands in the place of the United States for purposes of construing terms like "foreign", "domestic", "resident", "alien", "federal", and so on. The Internal Revenue Service announced its interpretation in I.T. 2946, XIV-2 C.B. 109, which stated in part:

> [T]he "United States" and the "Virgin Islands" are separate and distinct taxing jurisdictions although their income tax laws arise from an identical statute applicable to each. In construing the [income tax laws], it will, of course, be necessary in some sections of the law to substitute the words "Virgin Islands" for the words "United States," in order to give the law proper effect in those islands. From the viewpoint of the Virgin Islands citizens of the United States residing in the islands must be considered as resident aliens. . . .

This interpretation was acknowledged with approval by the Court of Appeals for the Third Circuit[3] in *Dudley v. Commissioner*, 258 F.2d 182, 185 (3d Cir. 1958), and has been consistently applied by the Third Circuit in subsequent cases. *See Chicago Bridge and Iron Co. v. Wheatley*, 430 F.2d 973 (3d Cir. 1970), *cert. denied*, 401 U.S. 910 (1971), *Great Cruz Bay, Inc. v. Wheatley*, 495 F.2d 301 (3d Cir. 1974), *Vitco, Inc. v. Government of the Virgin Islands*, 560 F.2d 180 (3d Cir. 1977), *cert. denied*, 435 U.S. 980 (1978), *Danbury, Inc. v. Olive*, 820 F.2d 618 (3d Cir. 1987), *cert. denied*, 484 U.S. 964 (1987), and *Johnson v. Quinn*, 821 F.2d 212 (3d Cir. 1987).

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[3] The Third Circuit Court of Appeals has sole appellate jurisdiction over tax cases arising under the income tax laws in effect in the Virgin Islands. 48 U.S.C.A. §§ 1612, 1613, and 1613a.

Danbury, Inc. v. Olive, 820 F.2d 618, provides an excellent example of how the word-substitution scheme operates. In *Danbury*, the Third Circuit held that (i) for purposes of the Virgin Islands "mirror code," a Nevada corporation is a *foreign* corporation because it is not incorporated under the laws of the Virgin Islands, and (ii) under section 882(b) of the "mirror code," such a corporation is taxable only on its gross income from sources within the Virgin Islands and its gross income that is effectively connected with the conduct of a trade or business within the Virgin Islands. 820 F.2d at 622.[4]

Under the Third Circuit's mirror-system decisions, the word-substitution scheme is methodically applied "except where it is manifestly otherwise required." *Johnson v. Quinn*, 821 F.2d 212, 214. *Chicago Bridge and Iron v. Wheatley*, 430 F.2d 973, involved a situation where this approach permitted deviation from strict word substitution. In *Chicago Bridge & Iron*, the Third Circuit had to determine whether the mirror code in effect in 1965 entitled the taxpayer, a Delaware corporation deriving all of its income from a business in the Virgin Islands, to the deduction then allowed under section 922 of the Internal Revenue Code to a Western Hemisphere Trade Corporation ("WHTC"). Under section 921 of the Internal Revenue Code, a WHTC was a "domestic corporation" that did all of its business in the Americas and derived at least

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[4] *Danbury* also held that, since the taxpayer in that case was a Virgin Islands "inhabitant," it was obligated to pay its United States income tax liability on its worldwide income to the Virgin Islands treasury under 48 U.S.C.A. § 1642, a statutory provision not at issue in this case.

95 percent of its income from "sources without the United States." The Virgin Islands contended that the taxpayer was not a WHTC for mirror code purposes because, under the mirror code, the term "domestic" meant "incorporated in the Virgin Islands." The Third Circuit rejected this argument on the ground that, if strict word substitution were followed in identifying WHTCs under the mirror code, "every business enterprise operating solely on the mainland could qualify for the [WHTC] deduction merely by incorporating in the Virgin Islands," a result that was manifestly incompatible with "a deduction intended solely to benefit business activities outside of the United States." 430 F.2d at 973.

The instant case involves the deductibility, under mirror code section 164(a), of the ten-percent surtax imposed by the Virgin Islands in 1986, 1987, and 1988 (*see* 33 V.I.C. § 581(a)), pursuant to authority granted by Congress to the Virgin Islands Legislature in 1976. *See* P.L. 94-392, § 5, 90 Stat. 1195. Section 164(a) provides, in pertinent part:

> Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:
>
> * * *
>
> (3) State and local . . . income . . . taxes.

In the proceedings below, Petitioner took the position that the surtax imposed by the Virgin Islands is deductible under section 164(a), reasoning that the surtax is described by the phrase "State and local income taxes."

(Pet. 4.[5]) Respondent took the position that, *under the mirror code*, the surtax is a "federal income tax," which is not allowed as a deduction under section 164(a) and is explicitly disallowed as a deduction by section 275(a)(1). (*See* Resp. App. 1a.) The court of appeals below agreed with Respondent (Pet. App. 3), and this Petition for a Writ of Certiorari followed.

REASONS FOR DENYING THE WRIT

A. The Decision Below Raises No Issue Worthy of Review by This Court

This case involves nothing more than a simple application of the Virgin Islands' "mirror system" of taxation by the Court of Appeals for the Third Circuit, which, by act of Congress, has sole appellate jurisdiction over Virgin Islands tax cases. The court of appeals below examined the applicable statutes, reviewed the mirror system precedents, and, consistently with those precedents, concluded that the surtax imposed by the Virgin Islands is not a deductible "State and local income tax" within the meaning of mirror code section 164(a).

Since the mirror system precedents do not demand strict adherence to the substitution of "Virgin Islands" for "United States" in situations where it is "manifestly otherwise required," *Johnson v. Quinn*, 821 F.2d 212, 214, the

[5] "Pet." references are to the Petition for a Writ of Certiorari. "Pet. App." references are to the Appendix to the Petition. "Resp. App." references are to the Appendix to this Brief in Opposition.

court of appeals below had to make a *judgment* – that is, it had to decide whether it is *manifestly required* that the surtax be treated as a deductible State and local income tax. In reaching the judgment that such treatment is not manifestly required, the court of appeals considered and rejected Petitioner's arguments. In particular, the court of appeals considered Petitioner's argument that Congress intended the surtax to be deductible under the mirror code, and it found the argument wanting. (Pet. App. 13-14.)

In sum, the decision below involves an interpretation of statutes that are applicable only to Virgin Islands taxpayers, it does not conflict with any decision of this Court or of any other circuit, and it is consistent with prior Third Circuit decisions and longstanding administrative practice.

B. The Decision Below Does Not Raise the Questions Presented in the Petition

In an attempt to make the decision below appear to warrant this Court's review, Petitioner asserts that the court of appeals ignored certain decisions of this Court regarding statutory construction by (i) failing to consider the impact of later legislation (Pet. 7-8, 13, 15-16), (ii) substituting its own judgment for that of Congress (Pet. 18-19), and (iii) failing to consider all of the wording of the applicable statutes (Pet. 20-21). Petitioner's assertions mischaracterize the decision below.

1. The Court of Appeals Below Did Not Fail To Consider the Impact of Later Legislation

Petitioner asserts that, in determining whether the surtax imposed by the Virgin Islands is a "State and local income tax" for purposes of section 164(a) of the mirror code, the court of appeals below ignored the second sentence of section 1274(b) of the Tax Reform Act of 1986 (hereinafter "TRA 86"), Pub. L. No. 99-514, 100 Stat. 2085, 2597. (Pet. 7-8, 13, 15-16.) Section 1274(b) of TRA 86 states:

> (b) AUTHORITY TO IMPOSE NON-DISCRIMINATORY LOCAL INCOME TAXES.—Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. *Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies.*

(Emphasis added.)

In fact, the court of appeals expressly considered this "later" legislation[6] and concluded that there is no evidence that Congress intended the Virgin Islands surtax to be deductible from Virgin Islands taxable income. (Pet. App. 8-10, 13-14.)

Moreover, it is apparent merely from an informed inspection of the second sentence of TRA 86 § 1274(b)

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[6] The surtax in question was authorized in 1976 by P.L. 94-392, § 5, ten years prior to the enactment of TRA 86. (*See* Pet. 3.)

that the sentence is intended to address the treatment of locally imposed Virgin Islands income taxes *under the Internal Revenue Code, not under the mirror code.* Section 901 of the Internal Revenue Code permits United States taxpayers to claim a tax credit with respect to income taxes paid or accrued "to any foreign country *or possession* of the United States." Code section 901(b). Section 901 of the mirror code, on the other hand, permits Virgin Islands taxpayers to claim a tax credit with respect to income taxes paid or accrued to any foreign country *or to the United States.* I.T. 2946, XIV-2 C.B. 109, 110 (1935), *updated and restated,* Rev. Rul. 73-315, 1973-2 C.B. 225. Thus, the second sentence of TRA 86 § 1274(b), which denies the section 901 credit for certain taxes imposed by the Virgin Islands, clearly applies for purposes of the Internal Revenue Code only, and not the mirror code. In fact, the legislative history of TRA 86 expressly states: "The Virgin Islands is provided with the authority to enact nondiscriminatory local income taxes (which *for U.S. tax purposes* would be treated as State or local income taxes) in addition to those imposed under the mirror system." H. Rep. No. 426, 99th Cong., 2d Sess., 488-89, S. Rep. No. 313, 99th Cong., 2d Sess., 483 (emphasis added).

2. The Court of Appeals Below Did Not Substitute its own Judgment for That of Congress

Petitioner asserts: "By determining that the Virgin Islands should receive the full economic impact of the maximum Surtax rate, the Third Circuit Court of Appeals substituted its judgment for that of Congress and judicially legislated a result not intended by Congress." (Pet.

18.) This assertion is false. As Petitioner concedes, there is absolutely no evidence, outside the statute itself, of Congress's intent regarding the quantum of economic benefit to be derived by the Virgin Islands from a surtax. (Pet. 17.) Therefore, no determination by the court of appeals on that subject can properly be viewed as "contrary to the intent of Congress." (*See* Pet. 19.) In fact, the court of appeals simply performed the judicial function of interpreting the applicable statutes. The court observed that the 1976 Congressional enactment authorized the Virgin Islands to impose a surtax at a rate of up to ten percent, and it reasoned that interpreting section 164(a) of the mirror code so as to allow the surtax to be deducted "would not only defy rationality but would serve to frustrate Congress's stated intention of allowing the Virgin Islands to levy a full 10% surtax on income." (Pet. App. 12.) The court's reasonable inference conflicts with no decision of this Court.

3. The Court of Appeals Below Did Not Fail To Consider all of the Wording of the Applicable Statutes

Petitioner asserts that, by refusing to apply section 164 of the mirror code in the manner urged by Petitioner, the court of appeals "ignored" portions of the applicable statutes, in alleged violation of this Court's decisions. The only statutes referred to by Petitioner are 48 U.S.C.A. § 1397 and section 164 of the Internal Revenue Code. Both of those provisions were scrutinized and interpreted by the court of appeals below. Petitioner's assertion is erroneous.

CONCLUSION

The decision below has limited applicability, does not conflict with any precedent of this Court or, indeed, of any other court, is consistent with prior Third Circuit decisions and longstanding administrative practice, and does not raise any issue of sufficient importance to warrant this Court's attention. Thus, no basis exists for granting the Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit. Respondent respectfully requests that the Petition be denied.

Respectfully submitted,

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APPENDIX

Internal Revenue Code section 275.

(a) GENERAL RULE. – No deduction shall be allowed for the following taxes:

(1) Federal income taxes. . . .